Some Recent Developments in Corporate Law within the Common Market

Walter Van Gerven

I.

There is no uniform corporate law within the Common Market. Each of the six member States has its own system which, in almost all of the six States, has either been revised recently (Germany, France) or is in the process of being revised (Belgian, Italy, Holland). Apart from such nationally inspired reforms, efforts have been made, at the initiative of the E.E.C. institutions, to promote common rules between the six member States. These efforts are to be situated on three different levels.

First, there are the efforts to coordinate the rules of the six national laws insofar as needed to implement the right of establishment to which all E.E.C. nationals are entitled in each of the member States. Such coordination tends, as set forth in art. 54, par. 3 (g) E.E.C. Treaty, to "render of equal value the guarantees which member States require of companies within the meaning of article 58, par. 2, so as to protect the interests both of members and outsiders." On the basis of this article the E.E.C. Council has enacted, on March 9, 1968, a directive—to be implemented by each of the member States—coordinating some national legal provisions concerning disclosure, validity, of legal acts made by officers of the company on behalf of the company, and grounds of nullity of companies (E.C. Official Gazette of March 14, 1968, No. L 65/8).

Two other directives have been prepared by the E.E.C. Commission and submitted to the Council for enactment, the first relating to the coordination of national legal provisions concerning the formation and the capitalization of national legal provisions concerning the formation and the capitalization of companies (E.C. Official Gazette of April 24, 1970, No. C 48/8); the second relating to the coordination of national legal provisions

*Professor of Commercial Law and Vice-Chancellor, University of Louvain. Visiting Professor, University of Chicago, 1968–69. Member of the Brussels Bar.

concerning (mainly intra-State) mergers (E.C. Official Gazette of July 14, 1970, No. C 89/20). All of these directives or proposed directives relate only to specific company types (mostly the *société anonyme* type); they do not purport to unify national legal provisions but only tend to coordinate them.

The second level on which efforts are made in the field of corporate law concern some points which, according to article 220 of the E.E.C. Treaty, are to be negotiated between the member States. They are a.o. "the mutual recognition of firms or companies . . . , the maintenance of their legal personality, if their registered office is transferred from one country to another, and the possibility of mergers between firms or companies which are subject to different domestic laws." Until now visible progress has only been achieved in respect of the first point mentioned, by the signing on February 29, 1968 of a Treaty on the mutual recognition of companies and bodies corporate. This result was the easiest to achieve since recognition of foreign companies was in most member States, if not in all, already secured by virtue of existing legal provisions or practices. In respect of the other points, *e.g.* inter-State mergers, only extensive preparatory work has been done. In connection with the latter subject, reference should be made, though, to two proposed E.E.C. directives concerning the taxation of inter-State mergers and stockholdings (E.C. Official Gazette of March 22, 1969, No. C 33).

Efforts are finally made on a third level which is the level of the *Societas Europaea* (S.E.). Instead of coordinating existing national law provisions (art. 54, par. 3 (g) referred to above), or instead of negotiating an international Treaty between the member States to set out some rules on conflicts of law (art. 220 referred to above), efforts on this level aim to introduce a uniform company type which will be available, under certain conditions, in each of the member States in addition to the existing company types. After considerable preparatory work, the Commission has approved and submitted to the Council on June 30, 1970 a lengthy (284 articles) proposed regulation to be taken on the basis of article 235 E.E.C. Treaty, concerning the introduction of a European company-type (E.C. Official Gazette of October 10, 1970, No. C 124).

The purpose of this report is not to discuss the reforms which are carried on in each of the six member States, such reforms being too different from one country to the other, nor to discuss the above-mentioned efforts to achieve a certain degree of harmonization between the laws of the member States, such efforts still being too much in the stage of preparation. Instead, we would like to discuss briefly a few trends which seem to be common, each more than the other, to the six national laws and most of which are

reflected in the documents prepared by the E.E.C. institutions, mainly in the E.E.C. proposed regulation for a European company (*Societas Europaea)* type (hereinafter referred to as "S.E."). In discussing these trends we shall consider almost exclusively the larger corporation type.

II.

The alienation of shareholders from the life of the company is a well-known phenomenon in larger corporations on which there is no need to insist. This phenomenon raises the question of shareholders' protection. In a discussion of modern German corporate law, Professor Vagts ("Reforming the 'modern' corporation. Perspectives from the German," 80 *Harvard Law Review*, 1966-7, p. 23 ff., on p. 59 and ff.) points out that the U.S. shareholder has a number of safeguards which his German (or for that matter his European continental) counterpart does not enjoy. These safeguards are: the pervasive protection in the U.S. of the SEC; the protection given in the U.S. by a vigorous accounting profession; the stringency of disclosure provisions; the far more frightening effect of shareholders' actions kept alive by, among other factors, contingent fee arrangements—a practice not recognized on the Continent.

Although recent changes, or proposed changes, in the national laws of most of the E.E.C. countries aim to draw benefit from the American example to strengthen the shareholder's protection, *e.g.* in respect of disclosure requirements or proxy regulations (see *e.g.* for Germany: Steefel and von Falkenhausen, "The new German stock corporation law," 52 *Cornell Law Quarterly,* 1966-7, 518 ff., particularly on p. 542 ff.), it is unlikely that these changes will achieve much in associating the shareholders more closely with the life of the company. The main reasons therefor may be on the one hand the widespread use of bearer shares, which makes communications with, from or between shareholders more burdensome, and on the other hand, it would seem at least for the time being, the greater extent of indifference and passivity on the part of European investors towards stockholdings. The absence of efficient shareholder protection in the larger company type may have caused, as it is suggested by Professor Vagts, the institution of an intermediary body, the supervisory board, whose task is to control management on behalf of the shareholders.

Following the German example—which has inspired both the new French company law of 1967 and the proposed Belgian and Dutch corporate laws—the E.E.C. proposal for an S.E. provides three different policy making bodies in the company: management composed of one or more

members designated by the supervisory board (art. 63); the supervisory board composed of three, or a multpile of three, members of which two thirds are elected by the shareholders and one third by the employees (see below) (art. 74); and the shareholders' meeting. Management has all powers which are not explicitly granted to the other organs of the company; it represents the company *vis-à-vis* third parties subject, however, to prior approval by the supervisory board in respect of certain important legal acts, namely those concerning the closing or transfer of the enterprise or important parts thereof, important reductions or extensions of the corporate activity, important changes in the organization of the enterprise and the beginning or ending of a permanent cooperation with another enterprise (art. 66), and subject also to prior consultation of the work council (see below).

The charter of the company can make further acts dependent upon the approval of the supervisory board. All these limitations, however, cannot be invoked against third persons (art. 66). The shareholders' meeting, on the other hand, has certain powers which are limitatively enumerated in art. 83: they concern the increase or reduction of capital; the issue of convertible bonds; the designation or revocation of members of the supervisory board; the institution of shareholders' actions; the appointment of statutory auditors; the allocation of profits; the power to amend the charter, to dissolve or to transform the company, to merge, to associate or to alienate the company with, or to, another company (art. 83). Between these two organic acts the supervisory board which has for assignment to control management permanently without participating in management or representing the company, except in those cases which are explicitly enumerated in the proposed regulation.

Apart from designating the managers of the company (and revoking such appointments for serious cause) and approving certain important decisions, as indicated above, the supervisory board is entitled to be informed quarterly, or whenever it requests, concerning the management of the company. It may give its opinion concerning all matters of importance to the company (art. 73). It may institute, at its own initiative or at the request of the shareholders' meeting, court proceedings for damages against one or more managers of the company (art. 72). Last but not least it may, in agreement with management, establish the annual financial statements, and decide to reserve half of the annual profits (art. 213 and 217). Only if no agreement is reached between management and the supervisory board, it pertains to the shareholders' meeting to establish the financial statements and to allocate (reserve or distribute) all of the profits.

It may appear from the last point, and from the fact that the supervisory

board has the power to designate the managers of the company, that there is a tendency, in the proposal for an S.E. libi in the new or proposed corporate laws of most of the member States, to transfer certain powers which traditionally were considered to be shareholders' privileges to the supervisory board. On the other hand, however, the individual shareholders' powers are strengthened in this proposal for S.E., by granting a derivative suit to a shareholder or shareholders possessing 5% of the outstanding shares or, alternatively, shares for an amount of 100,000 dollars (art. 72), and by authorizing a shareholder or shareholders possessing 10% of the outstanding shares or shares for an amount of 200,000 dollars (as well as the representative of a group of bondholders and the work council), to request the court to designate a special auditor in case of serious misgivings concerning the ability or the performance of the managers or members of the supervisory board (art. 97).

III.

The alienation of shareholders referred to in the preceding section is counterbalanced to a certain extent by the tendency to integrate employees in the corporate structure. The proposed regulation for an S.E. contains a chapter on the representation of employees in the S.E. Such representation will occur through the organization in each S.E. having a permanent establishment in more than one member State, of a European Work Council (art. 100). Such council will function in addition to the work councils which in accordance with national provisions may have been instituted in any one of the permanent establishments (art. 101). Members of the European work council are elected by the employees of the separate permanent establishment in accordance with the rules in effect in the member State where the permanent establishment is located, for the local work councils (art. 103 and 104).

The work council will meet with management at regular intervals and will be informed by management through quarterly reports about the general economic situation of the company (art. 120). It is entitled to receive the same information as the shareholders, among which are the annual financial statements (art. 121). In respect of a whole series of problems being of immediate concern for the employees, such as general working conditions and safety regulations, management cannot take a valid decision without prior approval from the work council (art. 123). For other points the council must be heard (art. 124), or have been consulted in writing (art. 125); the latter applies in respect of the decisions enumerated in the

preceding section for which the management needs the prior approval of the supervisory board. The powers thus conferred upon the work council are, however, limited to matters for which no collective bargaining agreements have been concluded (art. 119). Conflicts between the work council and management will be arbitrated by a special arbitration commission composed on a 50/50 basis, and presided over by a mutually agreed on, or court appointed, chairman (art. 128).

The institution of a work council materializing co-determination mainly in social (*i.e.* non economic) matters, is in accordance with the law of the six member States, be it that the rules as to the size of enterprises for which a work council must be instituted, the composition and particularly, the powers of the work council differ considerably from one State to the other (for a description of the law of some European States see *The Company, law structure and reform in eleven countries,* edited by C. de Houghton, Pep, London, 1970, p. 199 ff.). In addition, however, to the institution of a work council, the proposed regulation for an S.E. also provides for a one-third representation of employees in the company's supervisory board (art. 137), the other two-thirds of the board being elected by the stockholders (art. 74).

The charter may even provide for a larger representation, whereas on the other hand no representation of employees will be provided for if at least two-thirds of the employees of the S.E. so elect (art. 138). The proposal for an S.E. in respect of representation of the employees on the supervisory board of the company, is substantially in line with the general German co-determination law applicable to certain company types, but falls short of the specific German provisions for the Coal and Steel sector, where shareholders and employees are equally represented in the supervisory board, and where employees have moreover a representative on the managing board of the company. It also differs considerably from a recently proposed Dutch law on co-determination for larger companies, which provides that the members of the supervisory board will be designated by co-optation subject, however, to a right of objection vested in both the shareholders' meeting and the work council. In view of such co-optation the supervisory board may act upon suggestions made by the shareholders' meeting, the work council and even management.

Co-determination in economic matters through representation of the employees in the supervisory board of the company, or even in the managing board, is, as one knows, a very controverted subject both in management and trade union quarters. The idea of co-determination is opposed by managers who are afraid of sharing power with trade union representatives

in matters which are of no direct concern to the employees, and by trade union representatives who are afraid that participation of the employees in management may make employees more understanding and therefore less vindictive than when the bargaining is carried out from the outside by trade union representatives. Also, it is difficult to discuss the effects of co-determination on economic issues.

Professor Vagts who has examined this point (among others) in connection with the German experience (art. cit., on p. 69–72) tends to think that co-determination may in certain sectors (like coal and steel) have somewhat spurred the rise of wages—which however, may have been compensated for by a smaller amount of man-hours lost through strikes—may have caused more fringe benefits for the employees, the labor representatives "trading their assent to new investments for welfare expenditures," has almost certainly procured increased stability and continuity in employment, seems not to have had a restrictive effect on new investments, the labor representatives "being quite willing in general to expend money on facilities so long as the alternative is a payment of dividends." On the other hand, co-determination seems not to work against price increase "particularly when this is associated with a wage or fringe benefit increase."

Integration of employees in the corporate structure on the one hand, and alienation of shareholders on the other, seem to have found an equilibrium, within the corporate structure, in the supervisory board—as is best shown, it seems, by the above-mentioned new Dutch proposal, according to which members of the supervisory board are designated by co-optation—provided, however, as expressed by a veto right, that they are acceptable both to the shareholders' meeting and to the work council. Through this supervisory board both shareholders and employees are called to control the ever-strengthening power of professional management. Many Europeans are fond of viewing this solution as a hyphen between Marxist socialism and American capitalism.

Co-determination, and the integration of labourers in capitalistic structures for which it stands, may be seen in a broader perspective. In a report prepared in 1966 by Mr. Zijlstra on behalf of the E.E.C. Commission, concerning economic policy and competition in the E.E.C., and the member States, six types of economic planning are distinguished, the mildest form of planning being the preparing and publishing by a government agency of mere prognoses concerning future economic developments, the most extreme one being the type of planning which is characteristic for socialist countries, *i.e.* detailed and for all enterprises binding planification elaborated by a central government agency.

The last but one most extreme type is a planning one which is now in effect in at least two E.E.C. countries, France and Belgium. According to this type of planning, general goals of economic policy are laid down by the authorities, which goals are then pursued not only by indirect means, such as influencing the flow of national income, money and production, but also by specific incentives which are only available for private enterprises which, in consideration for the incentives obtained, agree to comply with the general and specific objectives of the general plan. Such plan is also binding upon governmental agencies and public enterprises engaged in economic activities. In both countries the general (five year) plan is elaborated by a planning authority in accordance with a two-stage procedure: during the first stage the fundamental options are proposed and approved, during the second stage the objectives are further elaborated; in both stages Parliamentary approval is required but only after extensive consultation, on a regional and a national level, with all kinds of professional groups, amongst which enterpreneurial and trade union groups, and economic institutions in which both groups are represented.

The collaboration of trade unions in the elaboration of the plan is another sign of integration of labourers—not only, as is shown by the co-determination laws discussed above, on the level of the enterprise, but also on a national level—in the economic decision-making process. (It may be interesting to note that in countries like Germany and Holland where co-determination on the enterprise level is most advanced, economic planning is of a milder type than in France and Belgium where co-determination on the enterprise level seems to be less in demand).

IV.

In the first section of this report reference was made to the efforts of the E.E.C. authorities to coordinate the national legislation of the member States, in respect of intra-State mergers—as well as to propose international rules between the member States to facilitate inter-State mergers. These efforts purport to provide legal rules to effect concentration between enterprises by merging separate legal entities into one and the same legal entity. The same effect can be achieved of course through the acquisition by one enterprise (which will be called hereinafter the dominating enterprise) of all or virtually all of the capital shares of one or more enterprises which will thus remain subsidiary companies having a separate legal entity. If the dominating company does not acquire all the shares of the subsidiary and a minority of the shares are held by shareholders not pertaining to the group of the dominating company, a special problem arises as shown in a recent decision of the Court of Appeals of Paris dated

May 22, 1965 (Fruehauf Corp. v. Massardy, *Recueil Dalloz*, 1968, *Jur.*, 147 ff.)

In this case the American majority shareholder, Fruehauf International, had instructed the management of its French subsidiary company not to perform under a contract made by the French subsidiary for the sale of material to be exported to communist China, on the ground that such delivery appeared to be in conflict with U.S. regulations. Following these instructions, the members on the Board representing the French minority shareholders, tendered their resignations and requested the designation of an administrator to perform the contract in the interest of the French subsidiary company. The commercial court of Corbeil granted the request, considering that the non-performance of the contract would result in severe damages for the French subsidiary which might endanger the very existence of the company and, consequently, the employment of more than 600 company employees. On appeal, the Paris court substantially confirmed the judgment, holding that preference should be given to the interest of the French company over the interest of the majority shareholder.

The special problem illustrated by the *Fruehauf* decision concerns the conflict between economic reality, which is that a company is subordinated to the interests of a larger group of which it is part, and legal structure, which is that the subsidiary company has its own legal entity supposedly giving form to a separate corporate interest. Such separate corporate interest is of the utmost importance not only for minority shareholders who will not be compensated for harmful consequences, affecting the subsidiary company, of decisions dictated by the majority shareholders in function, and to the advantage of the overall interest of the group, but also for creditors of the subsidiary company who can only enforce their claim on the assets of the subsidiary.

This conflict has led to special legislation in Germany referred to as *Konzernrecht* (whereas in other member States the desirability of such legislation is still controverted), which has served as an example for chapter VII of the proposed S.E. regulation (art. 223 ff.). After having defined the concept of *Konzern* and *Konzern* enterprises—two conditions, eventually to be interpreted by the E.C. Court of Justice in Luxemburg, must be fulfilled: a lien of subordination of one or more enterprises *vis-à-vis* the dominating enterprise and a common leadership—the proposed regulation for an S.E. provides special guarantees for so-called "free" shareholders of the subsidiaries (*i.e.*, shareholders not pertaining to the *Konzern*) on the one hand and for creditors of the subsidiaries on the other hand.

As to the free shareholders, the proposal grants them the right to quit the

subsidiary company either by selling shares to the dominating company for a fair price (art. 229) or, at their option, by exchanging their shares for shares of the dominating company (art. 230), and contains provisions outlining the procedure to determine the price and the exchange rate (art. 232–237). The dominating enterprise may choose, however, to convince the free shareholders not to quit by promising to pay them a yearly compensation in proportion to the face value of their shares (art. 231). As to the creditors of the subsidiary companies, the proposed regulation declares the dominating company jointly and severally liable for the liabilities of its subsidiary companies provided, however, that the creditor has first tried to enforce its claim against the subsidiary (art. 239).

The proposed regulation further contains disclosure requirements in that a *Konzern* enterprise must make its affiliation with the *Konzern* public (art. 226), and must also publish a consolidated balance sheet (art. 237). As a consideration for these various guarantees, but particularly for those granted to the "free" shareholders, the proposed regulation provides explicitly that the management of a subordinated company may not refuse to comply with the instructions given by the dominating enterprise, on the ground that the instructions are incompatible with the interests of the subsidiary (art. 250).

As said above, to-date specific *Konzern* law is only in effect in Germany. The question whether it should be introduced is being debated in the other member States, particularly in the Netherlands. The fact that it has been included in the E.E.C. proposal for an S.E. seems to indicate, however, that the idea of specific *Konzern* rules gains ground. It is hard to know why *Konzern* law seems to have special appeal on the European continent whereas it seems to have no counterpart in Anglo-American law. As possible reasons can be cited: the concentration of enterprises which is very much needed in the common market and which, because of the intricacy of legal provisions concerning mergers between companies, can only be easily achieved through the acquisition of shares; the lesser degree of protection, as compared with the U.S. and England, to minority shareholders by general corporate or other rules.

It should be emphasized at the end of these brief remarks, that the existence of a specific *Konzern* law does of course not prejudice the application of national or E.E.C. anti-trust law. Still, it may be recalled that the E.E.C. Commission, in its 1966 memorandum on concentration of enterprises within the Common Market, has taken a rather favorable look at concentration by giving voice to its opinion that article 85 of the E.E.C. will apply only exceptionally to concentration agreements, and that con-

centration must be viewed instead from the angle of article 86, *i.e.* abuse of dominant position.

V.

Two or more corporations may wish to cooperate without losing their corporate entities through a merger, or without losing their autonomies by being purchased by a dominating company. Such cooperation may be achieved either by setting up a joint venture between the cooperating companies, or by entering into an association agreement. In France these two forms have not been considered to suit all purposes, the first device (joint venture) allegedly being too rigid, the second one (association) which would have no separate legal entity, being too loose. Accordingly, the French government has instituted by presidential Decree of September 23, 1967 a new body corporate called the *groupement d'intérêt économique* (G.I.E.) (see: *Recueil Dalloz Sirey*, 1967 *Législation*, p. 361).

The G.I.E. is conceived as a very flexible body corporate which may be used by big or small companies, but also by physical persons to give legal personality to a common activity for a certain period of time. The G.I.E. must have an economic purpose which, however, must not necessarily be to generate profits. It may, or may not, have a capital. The articles of association may freely determine the organization of the company in respect of, among other things, voting power, quorum and/or voting majority, management, control, dissolution and winding up of the company. In spite of this flexibility the G.I.E. enjoys legal personality as of its matriculation in the Registry of Commerce. Unless otherwise agreed with a contracting party, the members of the G.I.E. are held to be jointly and severally liable for the obligations of the company, which is normal, considering the fact that the G.I.E. can be formed without capital. The G.I.E. may issue bonds, if it is formed by companies which are all entitled to do so themselves. Taxwise, the G.I.E. is entirely transparent, *i.e.*, profits are taxed as part of the income of its members.

It should be added that the Italian Civil Code of 1942 did already contain similar provisions (art. 2602 ff.), and that the G.I.E. is considered by those who believe that the E.E.C. proposal for an S.E. is too complicated, as a valid alternative for the S.E.